

LONGWOOD UNIVERSITY

**INTERIM REPORT
ON THE FINANCIAL STATEMENT AUDIT
FOR THE YEAR ENDED
JUNE 30, 2004**





Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

July 15, 2005

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
Longwood University

During the audit of fiscal year 2004 for Longwood University (University), we encountered problems in conducting our examination. Contributing to these problems were University vacancies and other personnel issues. In dealing with these problems, we have worked with University management and staff, and while we have not completed the audit for fiscal year 2004, we believe it is in the best interest of the University and the Commonwealth to provide an interim report of our findings so that management and the Board may begin to address these issues.

All of Virginia's colleges and universities experienced budget cuts during fiscal years 2002 through 2004 and many responded by reducing administrative positions. The University first reduced administrative costs and only reduced educational programs when absolutely necessary. In addition to the budget cuts, management experienced staff turnover, which was compounded by the excessive time spent finding and recruiting new staff and managers.

The University finds itself in the position of having to address three fundamental issues in order to move forward. The first is ensuring that daily operational functions such as revenue collection, payroll, vendor payments, and student billing are completed and properly recorded. Second, management will need to determine if it has sufficient resources to continue its system implementation efforts and where it should concentrate these efforts. Finally, how does the University systemically address the issue of preparing the information and other needed data for financial statements for fiscal year 2005 and then 2004.

Ensuring that daily operational functions are completed and properly recorded will provide integrity to the financial information. To achieve this management should conduct a review of all year end reconciliations and transactions for reasonableness and make any necessary adjustments, for example the January 2005 \$6 million unrecorded deposit in the University's bank account, to the accounting system and/or CARS before month end close for fiscal year 2005. During the first few months of fiscal year 2006, management should define all daily, monthly, and annual processes to ensure the correct recording and budgeting authorization of all transactions. In addition, management must begin ensuring the continuity of

completing all reconciliations, including a review by knowledgeable staff and posting of all necessary adjustments to the accounting system and/or CARS in a timely manner.

Once management is comfortable that the University can record, properly authorize, and reconcile all transactions timely, they will need to determine if there are sufficient resources to continue the University's system implementation efforts and where to concentrate their efforts. Management should determine the cost effectiveness of allocating resources to documenting policies and procedures for processes that use the current general ledger system or waiting to develop policies and procedures for the processes that will use the new general ledger system. The results of this decision will dictate the implementation schedule for the new accounting system. Management should consult with the system project manager and system vendor when making this decision.

After defining processes, ensuring they are working, and setting the direction and timetable for changes related to the system development effort, management needs to begin systematically reviewing and preparing the information necessary to produce the financial statements for fiscal year 2005 and then 2004. This process will need to strike a balance between maintaining current operations and the new system development effort. While this process is a major milestone in the University's plan to address these issues, these financial statements will not have the same long term benefit to the University that having accurate current financial information and a new system will yield.

Immediate Concerns Affecting Operations

The first issue we believe management must address is ensuring that the University is processing all current transactions. As a result of not recording \$6 million of deposits in the accounting system for six months, which caused a \$5.7 million negative balance, the financial aid staff bypassed the system controls, ignored the account information, and recreated information to pay and monitor student financial aid by manually gathering independent information from bank source documents.

The University's processes must also ensure the proper authorization of a transaction before processing in the accounting system. All system accounts that incur expense activity should have budgetary controls to prevent overspending. Currently, the system controls allow staff to process payments in accounts that appear to have overspent their budget without requiring management's approval of the override.

This issue is our primary concern due to the Board's and management's need to rely on financial information from the accounting system and the University's need to prepare its federal Fiscal Operations Report and Application to continue receiving student financial aid.

Reconciliations

As management is conducting this review and defining the process going forward, they should ensure that there are reconciliation procedures that require completing the reconciliations timely, correcting reconciling items by making and posting adjustments timely to the accounting system, other internal University systems, all bank accounts, and the state accounting system. In addition, when reviewing reconciling items, the preparer must always provide a reasonable explanation with appropriate support.

The reviewer of the reconciliation should have a sufficient understanding of the University's systems and processes to understand what reconciling items indicate problems within the process, such as excessive errors due to incorrectly recording transactions and unrecorded transactions. The reviewer should also have the knowledge and understanding of the accounting system to determine if the proposed adjustments will correct the problems. Only when the reviewer is satisfied that the reconciliation has been properly prepared

and reconciling items resolved should they sign and date the work showing their approval of the reconciliation.

Policies and Procedures

As indicated above, the University will need at some point to document its policies and procedures. The extent of this documentation will depend on timing and which areas the University implements its new financial system. If the University delays implementation of the new system, it should do the minimum documentation necessary to maintain current operations. When it implements the new system, the University should fully document all of its new policies and procedures.

Current conditions within the Finance area arose from the loss of key staff and lack of anyone having an overall understanding of the work and processes necessary to maintain operations and prepare interim and year end reports, including financial statements. With limited staff, having well documented policies and procedures are necessary to ensure continuity of operations during key position vacancies and to provide documented processes a new person can follow.

Because maintaining policies and procedures is not normally a priority of any operation, they tend to become dated and of limited use. We recommend that the Board of Visitors and management have the internal auditor include a periodic review of these policies and procedures that cycle through the entire document over a three to five year period.

Management Oversight

Management must seriously consider their role in operations in their efforts to resolve the issues identified in this report. In addition to the policies and procedures previously discussed, management should determine what necessitates their oversight, at what level, and the intensity. When defining this role, management should consider assessing and monitoring staff levels relative to workloads, cross-training for critical processes, and developing a monitoring mechanism for key processes.

Specific Areas – Payroll

In the Payroll Division, we found a lack of formal internal policies and procedures, inconsistent receipt of support for payroll changes, and a lack of support for overtime pay. We also found no formal reconciliation between the University system and the Commonwealth Integrated Personnel and Payroll System (CIPPS) and leave balances, and no reconciliation between CIPPS and the Virginia Retirement System for contributions made on behalf of the University and its employees.

Management has instructed the Payroll Division employees to follow the State Comptroller's policies and procedures for payroll. However, these procedures do not address some the processes unique to the University. This lack of documented procedures to address those circumstances unique to the University and the vacancies of positions in the Payroll Division has contributed to the issues noted above.

Specific Areas – Fixed Assets

The University does not maintain an accurate asset listing in Longwood's Fixed Assets Accounting & Control System (LFAACS). The University performs annual inventories, but it does not resolve discrepancies between its physical inventory and its asset listing in a timely manner. Additionally, departments do not follow inventory instructions provided by the University's Materials Management Division. We found that 11 of the departments (18.6 percent) at the University had unresolved discrepancies and five of those departments had unresolved discrepancies for more than one inventory cycle. Without

management enforcing departments to follow inventory instructions and resolving discrepancies timely, the University runs the risk of having continued unresolved discrepancies involving capital assets in the future and misstating their fixed assets on the financial statements given that both controlled and capitalized assets fall under the same umbrella of internal controls.

We believe these steps and their order of priority provide management with the direction necessary to properly address the highest risk areas of the University's operations. Management has already made satisfactory efforts to begin addressing these issues. In all of management's efforts, they should strive to create an environment where they and the staff understand how their processes provide assurance that all transactions have appropriate authorization and are properly recorded and reconciled.

We discussed this report with management at a meeting held on August 4, 2005.

AUDITOR OF PUBLIC ACCOUNTS

SW/kva

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UNIVERSITY

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MEMORANDUM:

TO: Walter J. Kucharski,
Auditor of Public Accounts

FROM: Kathy S. Worster, *KW*
Vice President for Administration and Finance

Subject: Response to Management Report on Improving Internal Controls at Longwood University

DATE: August 04, 2005

Longwood University concurs with the findings of the report. Documenting processes and procedures is critical to establishing a solid internal control environment. Although we currently have many policies and procedures in place, work is underway to ensure that all policies and procedures are adequately documented. This work will be substantially addressed by January 2006.

KSW/cdw



LONGWOOD UNIVERSITY

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